Basis Points July 31, 2018

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Above the Fold

The news cycle continues to be dominated by Donald Trump as he makes claims that U.S. GDP growth could reach 8 percent to 9 percent, after Friday's news that the 2Q18 GDP annual growth rate was 4.1 percent. Though this second quarter number is the highest since the third quarter of 2014, Trump's claim has been mostly ignored. President Trump and Italian Prime Minister Conte met on Monday to congratulate the recently elected Italian populist. The President has been complimentary of the Prime Minister in the past, but Italy's relative inability to meet Trump's NATO defense spending demands might become a point of friction. In international news, Venezuelan inflation rates are expected to reach 1 million percent by the end of this year, according to the IMF. The economic collapse was driven by the collapse in oil prices, and fiscal policy mismanagement has prevented them from taking advantage of the recent oil price increases. UN data estimates that over 1.5 million people have fled the country since 2014.

Three Things

- Facebook stock got crushed last week, down as much as 20 percent on Thursday after the social-media giant showed signs of slowing growth and declining operating margins. The $100 billion loss in market value was the largest one-day decline in value for a stock in history. After enduring months of criticism from its data and privacy scandal, earnings were hurt on the higher costs that it will take to address the data and privacy issues going forward. The company told Wall Street the numbers won't get any better this year and revenue growth rates would decline in the third and fourth quarters. The quarter also saw Europe's implementation of strict new data laws, which Facebook said led to fewer daily visitors in that region. The CFO gave three different reasons why the company's revenue growth would decline: currency headwinds, greater investments in new kinds of content-sharing like disappearing videos, and greater user control over privacy, which cuts advertising revenue. The huge tech growth stocks have performed very well for so long, so this big miss was a shock to Wall Street analysts. Prior to the earnings report, Facebook had 44 Wall Street analyst buy ratings, two sells and two holds.
- General Motors has become a high-profile casualty of the recent trade wars, after cutting its 2018 profit forecast on surging prices for steel and aluminum. The stock slid 7 percent on the day they released 2Q earnings and is now down 9 percent for 2018. GM earnings will drop to about $6 a share, down from a previous projection for as much as $6.50 a share. Raw material costs will be a $1 billion headwind this year, and the strength of the Dollar has hurt profits as well, as the Argentine peso and Brazilian real are likely to drag on results through the remainder of 2018. GM had increased profit three years in a row, with a record $6.62 a share profit last year. Record income in China, market share gains in the U.S. and strong results at its financial division were positioning the company for more growth until those gains were diminished by the surge in steel and aluminum prices, as tariffs were put in place on the metals in June.
- Housing values may fall as baby boomers die or sell off to downsize. Fannie Mae's research group says that they see the beginning of a mass exodus looming on the horizon, where housing demand from younger generations is insufficient to fill the void left by waves of selling by older owners. Baby boomers, those Americans born between 1946 and 1964, own 32 million homes, which is 40 percent of every home in the country. The generation that is older than them own another 14 million homes. From 2017 to 2027, 11 million boomers will sell their homes and not buy another one. And between 2028 and 2038 another 14 million boomers will sell their homes. The size of older houses may be a problem also, as younger buyers prefer smaller and more efficient homes, closer to city centers and public transportation, so older folks may find it difficult to find a buyer for their five-bedroom "McMansion."

Did You Know

Southern California home sales slid sharply in June, falling to the lowest reading for the month in four years. Sales of both new and existing houses and condominiums dropped 11.8 percent year-over-year, as prices shot up to a record high. The weakness was especially bad in sales of newly built homes, which were 47 percent below the June average. Affordability and inventory constraints are likely the main culprits in last month's sales slowdown, as the median price paid for all Southern California homes sold in June was a record $536,250. Sales below $500,000 dropped 21 percent on a year-over-year basis. The rise in mortgage rates over the past six months has not helped at all, as higher rates increase significantly a borrower's monthly payment for an already expensive house. Rates are moving higher again this week, pointing to even further weakness in affordability.